1936

Examination of November, 1936

Minnesota State Board of Accountancy

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER, 1936

WEDNESDAY, NOVEMBER 18, 1936—8:30 A. M. TO 12:00 M.

Economics and Public Finance

(Answer ten questions—No. 3 obligatory)

QUESTION 1:

Should the present capitalistic system be continued in the United States or should the United States enter on a communistic or socialistic system? Discuss this question entirely from the economic standpoint.

QUESTION 2:

Name and explain the fundamental economic theories underlying the campaigns for the Presidency of Roosevelt, Landon, Lemke, Thomas and Browder.

QUESTION 3:

Explain the economic effects of the recently enacted tax on undistributed profits.

QUESTION 4:

Explain the recent agreement between England, France and the United States to create a stabilization of their currencies, indicating what its effect, if successful, will be on the economic situation in the United States.

QUESTION 5:

Our complicated taxation system is shown by two illustrations: One large manufacturer counted 378 different taxes paid by his concern. In a recent article J. B. Thomas shows that every loaf of bread at the present time carries 52 taxes: 6 paid by the farmer, 6 paid by the elevator man, 4 paid by the mill man, 11 paid by the railroad carriers, 7 by the trucksters, 7 by bread-wrapper manufacturers, and 11 paid by the bakery. Our tax system simply overlaps itself at every possible angle.

Suggest in a general way methods by which the Federal Government could secure its needed income by means of taxes not used by State or local governments, together with a lack of duplication of sources of income by State and local governments, keeping in mind the desirability from an economic standpoint of not utilizing hidden tax methods for such purposes.

QUESTION 6:

Discuss the Single Tax theory as propounded by Henry George, one statement in whose platform of 1890 was: "Since in all our states we now levy some tax on the value of land, the Single Tax can be instituted by the simple and easy way of abolishing, one after another, all other taxes now levied, and commensurately increasing the tax on land values, until we draw upon that one source for all expenses of government, the revenue being divided between local governments, State governments, and the general government, as the revenue from direct taxes is now divided between the local and State governments; or a direct assessment being made by the general government upon the states and paid by them from revenues collected in this manner."

QUESTION 7:

In a recent brochure, "Something for Nothing," by Harold L. Mack, much is said with regard to the relationship of the accountant to the public. The opening sentence is, "If I were asked to name the one activity upon which modern civilization is most dependent, I would unhesitatingly nominate bookkeeping for that supreme honor." Later we note, "The vital principle of correct accounting is that whoever contributes the cash is entitled to a proportionate money equivalent of assets. * * * It is the consumer who contributes the cash to create the surplus, and to the consumer must be credited the ownership of the surplus, not the stockholders. * * * The failure of accounting to reflect this has caused continual economic dislocation and must continue to do so until its priniciples are recognized and put into effect. * * * The major crime of bookkeeping is that it allows the sellers of goods to charge to the consumers the cost of factory, machinery, and capital necessary to produce and reproduce the goods; and, after the consumer has paid for them, it allows the seller to credit himself with the proceeds and retain ownership of the same." Discuss the economic principles involved in these quotations from an accountant's standpoint.

QUESTION 8:

Discuss the following statement which appeared in a recent text. "Man's greatest efficiency lies always, without exception, in his ability to employ the minimum amount of capital wealth from which he may obtain the maximum amount of consumable wealth."

QUESTION 9:

Over-population, mechanical development, and land monopoly have been cited as reasons for the vast amount of recent unemployment. Comment pro and con for each, giving any other reason which you think has been an important factor.

QUESTION 10:

Henry George said, "All capital is wealth; but all wealth is not capital." What did he mean? Give reasons for agreeing or disagreeing with him.

QUESTION 11:

Ralph Waldo Emerson said, "A man who cannot be acquainted with me, taxes me; looking from afar at me ordains that part of my labor shall go to this or that whimsical end,—not as I, but as he happens to fancy. Behold the consequences. Of all debts men are least willing to pay taxes. What a satire is this on Government! Everywhere they think they get their money's worth except for these." What is the primary function of Government?

QUESTION 12:

Are wages paid by capital or out of the product? Explain your answer.

QUESTION 13:

Explain the recent developments in Government utilizing cooperative enterprises to compete with industry.

QUESTION 14:

Explain the economic basis of the tariff agreements now being concluded with foreign countries.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER, 1936

WEDNESDAY, NOVEMBER 18, 1936—1:00 P. M. TO 5:30 P. M.

Practical Accounting

PROBLEM 1:

From the information following, prepare a summary by principal classes of accounts, of—

(a) Cash receipts and disbursements showing—
Liquidation of gross assets acquired at inception
Collections of current income
Miscellaneous receipts
Reduction of liabilities assumed at inception
Payment of current expenses
Miscellaneous
Balance, representing cash in bank as at September 30, 1936

(b) A reconciliation of net income with the excess of current cash income over current cash expenses as summarized in (a), with notations of the balance-sheet-account sources of the noncash income or expense.

Appended are the balance sheets of Successor Realty Corporation as at September 30, 1935 (date of inception) and as at September 30, 1936—

	September 30,	
Assets	*1935*	*1936*
Cash in bank	....	$15,257.37
Receivables—		
Lessees (Notes and Account)	$30,109.50	26,087.62
Accrued interest on—		
Mortgages	6,156.07	6,091.94
Installment contracts	1,214.08	726.15
Escrow deposit	8,350.00	10,400.00
Investments—		
Mortgages	236,050.00	196,000.00
Installment contracts	40,622.97	28,766.68
Sundry	500.00	2,150.00
Prepaid insurance and franchise taxes	2,512.04	5,183.16
Improved real estate	1,263,078.19	1,275,561.48
	$1,588,592.85	$1,566,224.40

Liabilities		
Account payable and accrued payroll	....	$2,012.76
Accrued real-estate taxes	$59,860.94	33,876.27
Deferred rental income	1,537.80	1,275.00
Reserves for losses in liquidation of—		
Mortgages	85,762.00	78,252.00
Installment contracts	18,715.97	12,362.84
Receivables	29,502.67	28,909.72
Reserve for depreciation on improved real estate	....	15,819.20
Capital stock	10,000.00	10,000.00
Paid-in surplus	1,383,213.47	1,383,213.47
Earned surplus	....	503.14
	$1,588,592.85	$1,566,224.40

Earned surplus represented net income for the current year, as shown by the following summary of income and expenses—

Particulars			*Amount*
Income—			
Rentals of improved real estate		$60,262.99	
Interest on—			
Mortgages	$13,627.14		
Installment contracts	2,586.40		
Sundry investments	42.50	16,256.04	
Profit on sale of sundry investments		155.00	$76,674.03
Expenses—			
Salaries and wages		$21,625.80	
Taxes and insurance		9,910.94	
Provision for uncollectible rentals and interest		3,000.00	
Depreciation on improved real estate		15,819.20	
Other expenses		25,814.95	76,170.89
Net income			$503.14

Postings from the cash-receipts and disbursements books for the year have been summarized therefrom thus—

Particulars	*Receipts*	*Disbursements*
Receivables—		
Lessees	$62,497.33	$2,911.53
Accrued interest on—		
Mortgages	10,969.22	
Contracts	1,756.41	
Investments—		
Mortgages	22,040.00	
Installment contracts	4,503.16	
Sundry	355.00	
Prepaid insurance and franchise taxes, of which $3,157.80 applies to future periods		3,235.92
Accounts payable ("other expenses") and accrued payroll		46,177.99

Accrued real-estate taxes (1934 and prior)		34,580.81
Interest on sundry investments	42.50	
Total gross charges and credits, respectively, to cash in bank	$102,163.62	$86,906.25

The receivables as at September 30, 1936, include the following current-year uncollected income—

Account	*Amount*
Lessees	$1,592.81
Accrued interest on—	
Mortgages	3,501.55
Installment contracts	685.20
Escrow deposit	350.00
Total	$6,129.56

Notes and accounts receivable as at September 30, 1936 include, also $619.81 of the cash disbursements during the current year charged to the accounts of tenants.

Liquidations of gross assets, in addition to cash collections thereon, may be summarized thus—

Particulars	*Credits Relating to* *Accounts Set up as at Sept. 30, 1935*	*Accounts Included in Income of Current Year*	*Charged to*
Mortgages and related accounts—			
Investment in mortgages	$18,010.00		
Accrued interest thereon	2,199.55	$522.50	
Notes and accounts receivable	1,383.29		
Sundry investments			$1,850.00(1)
Improved real estate			12,483.29(2)
Reserves for losses in liquidation of—			
Mortgages			7,510.00
Receivables			272.05
Total	$21,592.84	$522.50	$22,115.34

Notes—

(1) Includes accruals of current-year interest, $322.50.

(2) Includes accruals of current-year interest, $200.00.

Notes and accounts receivable—			
Charged off	$2,305.48	$747.50(1)	
Reserve for losses in liquidation of receivables			$3,052.98

Note—

(1) Charged against $3,000.00 provision in current year for uncollectible rentals and interest.

Contracts and accrued interest thereon—		
Installment contracts	$7,353.13	
Accrued interest	892.92	$425.00

Escrow deposit			$2,050.00(1)
Reserves for losses in liquidation of—			
Contracts			6,353.13
Receivables			267.92(2)
Total	$8,246.05	$425.00	$8,671.05

Notes—

(1) Includes accruals of current-year interest, $350.00.

(2) Includes accruals of current-year interest, $75.00 (charged against $3,000.00 provision in current years for uncollectible rentals and interest).

Deferred rental income, both at the beginning and end of the year, represents rental income for the succeeding month.

The account payable is an item of $750.00 representing an insurance premium charged to unexpired-insurance account.

Notes and accounts receivable as at September 30, 1936, include, also, $619.81 of the cash disbursements during the current year charged to the accounts of tenants.

Liquidations of gross assets, in addition to cash collections thereon, may be summarized thus—

	Credits Relating to		
Particulars	*Accounts Set Up as at Sept.* 30, 1935	*Accounts Included in Income of Current Year*	*Charged to*
Mortgages and related accounts—			
Investment in mortgages	$18,010.00	......	......
Accrued interest thereon	2,199.55	$522.50	......
Notes and accounts receivable	1,383.29	......	......
Sundry investments	......	......	$ 1,850.00(1)
Improved real estate	......	......	12,483.29(2)
Reserves for losses in liquidation of—			
Mortgages	......	......	7,510.00
Receivables	......	......	272.05
Total	$21,592.84	$522.50	$22,115.34

Notes—

(1) Includes accruals of current-year interest, $322.50.

(2) Includes accruals of current-year interest, $200.00.

Notes and accounts receivable—			
Charged off	$ 2,305.48	$747.50	......
Reserve for losses in liquidation of receivables	......	......	$ 3,052.98
Contracts and accrued interest thereon—			
Installment contracts	$ 7,353.13	......	......
Accrued interest	892.92	$425.00	......
Escrow deposit	......	......	$ 2,050.00(1)
Reserves for losses in liquidation of—			
Contracts	......	......	6,353.13

Receivables	......	......	267.92 (2)
Total	$ 8,246.05	$425.00	$ 8,671.05

Notes—

(1) Includes accruals of current-year interest, $350.00.

(2) Includes accruals of current-year interest, $75.00 (charged against $3,000.00 provision in current year for uncollectible rentals and interest).

Deferred rental income, both at the beginning and end of the year, represents rental income for the succeeding month.

The account payable is an item of $750.00 representing an insurance premium charged to unexpired-insurance account.

PROBLEM 2:

From the following information relating to The Ready-to-Wear Corporation which consists of estimated income and expense for the calendar year 1936, prepare statements of net income subject to normal tax, adjusted net income subject to the undistributed profits tax, and the net income subject to excess-profits tax.

	Estimated Profit-and-Loss Items for 1936
Gross sales	$3,600,000.00
Cost of goods sold	2,150,000.00
Interest received on municipal bonds	3,000.00
Interest received on corporation bonds	4,500.00
Compensation of officers	50,000.00
Dividends received on stock of taxable domestic corporations	6,000.00
Cost of stock determined to be worthless during taxable year	3,500.00
Income received from leased departments	75,000.00
Capital net loss from sale of assets	4,000.00
Rent paid	150,000.00
Interest paid on indebtedness incurred to purchase municipal bonds	1,500.00
Other interest paid	500.00
Personal-property taxes paid for 1935	10,000.00
Federal income taxes	25,000.00
Bad debts charged off	10,000.00
Dividends paid in 1936	50,000.00
Depreciation	20,000.00
Salaries and wages paid	625,000.00
Federal capital-stock tax accrued—	
For period 1-1-36 to 6-30-36	375.00
For period 7-1-36 to 12-31-36 (capital-stock tax paid July 7, 1936, $1,000.00)	500.00
Personal-property taxes accrued for 1936	12,000.00
Repairs	20,000.00
Retailers occupational taxes	105,000.00
Unemployment insurance tax	4,000.00
Charitable donations	5,000.00
Other allowable deductions	375,000.00

Other taxable income	7,500.00
Excess-profits taxes for 1936	3,588.00

It will be necessary to know the prospective amount of normal tax in computing income for other purposes. The following normal tax rates will apply to 1936 income:

	Income	*Rate*	*Tax*
First	$ 2,000.00	8%	$ 160.00
Next	13,000.00	11	1,430.00
Next	25,000.00	13	3,250.00
Balance	111,312.00	15	16,696.80
	$151,312.00		$21,536.80

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER, 1936

THURSDAY, NOVEMBER 19, 1936—8:30 A. M. TO 12:00 M.

Commercial Law

Agency
(Answer Three)

1. What is the general rule as to the duty of persons dealing with an agent regarding the agent's authority?
2. (a) What is an agency coupled with an interest?
   (b) What is an agency by estoppel?
3. Brown operated an automobile sales agency. He authorized a bank to honor checks drawn on his deposit by his agent, Jones. Brown's death occurs, of which fact the bank has no knowledge, and Jones continues to issue checks against the deposit. Brown's administrator brings suit against the bank to recover the amounts of the checks drawn on the deposit after the death of Brown. Must the administrator win or lose his suit? Why?
4. Adair, a real estate agent, makes a contract with Smith to sell his (Smith's) house and lot for $12,000, Adair to receive a commission from Smith of $600 for making such sale. Jenkins hears that Smith's house and lot is for sale and says to Adair "I will give you $750 if you can get me Smith's house and lot at $12,000." Adair accepts this offer and consummates the sale. After the sale Smith and Jenkins each learn about the commission Adair was to receive from the other, and each refuse to pay. Can Adair recover from both Smith and Jenkins or either of them. Give reasons for your answer.

Bankruptcy
(Answer Three)

1. After start of bankruptcy proceedings, what are the principal duties of the bankrupt?
2. (a) Who is a secured creditor within the meaning of the Bankruptcy Act?
   (b) Does the doctrine of marshalling assets apply to secured creditors of a bankrupt? Explain.
3. (a) How does the discharge of a bankrupt affect the liability of others who with him are on joint and collateral obligations?
   (b) What becomes of unclaimed dividends in bankruptcy, and when?
4. (a) What is a composition in bankruptcy?
   (b) When may an offer of composition be made, and how must it be accepted?

Contracts

(Answer Three)

1. (a) What is the rule in the interpretation of contracts as between general and special provisions?
   (b) What is the situation when renunciation is made of a contract, by one of the parties to it, before time fixed for performance?
2. (a) Does a contract for the sale of real estate differ in any way from a contract for the sale of personal property? If so, how?
   (b) Is there any difference in the measure of damage for the breach of such contracts? If so, state what, and how the measure of damage is ascertained in each?
3. John Doe, with intent fraudulently to escape his creditors, conveys valuable real estate to his brother-in-law, Richard Roe, without consideration, and under an agreement that Richard shall re-convey the real estate back to John at any time John may request. After the lapse of four years, John requests Richard to re-convey to him the said real estate, but Richard refuses to do so. What remedy, if any, has John against Richard?
4. Williams telegraphed Johnson asking the price of a certain quantity of coal which price Johnson sent. Williams replied that the price was too high. Johnson then telegraphed a lower price. Williams telegraphed back, saying, "consider coal sold, will see you tomorrow and arrange particulars." Williams failed to see Johnson the next day, and afterwards refused to take the coal; Johnson though in the meantime had himself bought a quantity of coal at a certain price with the sale to Williams in view. Williams was sued by Johnson for breach of contract. Could recovery be had? Give reasons for your answer.

Corporations

(Answer Three)

1. In what different ways may a corporation be proceeded against for ultra vires acts done or threatened or contracts entered into ultra vires?
2. (a) Can a corporation be sued by one of its stockholders?
   (b) To what extent may a corporation make by-laws for the transaction of its business?
   (c) What is the substance of the United States Supreme Court decision in the Dartmouth College Case, in the early days of the Republic?
3. At a meeting of a board of directors at which five members were present, director A moved that the corporation enter into a contract with director B, which contract was very advantageous to B. On vote, directors, A. B and C voted aye and directors D and E nay. The chair declared the motion carried and ordered the contract made. D consults you as to the validity of the action of the board. What would you advise him?
4. A manufacturing corporation as an accommodation gave its note payable to Brown or order, to enable Brown to raise money for his own personal benefit, and at the same time signed a note of Brown's payable to Green, or order, for the same purpose, designating itself as surety on the latter note. A purchaser of these two notes, before due, for full value and without notice, except the notes, brought suit to recover thereon against the corporation. (a) Can said purchaser recover on the first note? (Why? (b) Can he recover on the second note? Why?

Insurance

(Answer Three)

1. (a) If an insurance policy refers to the application and expressly makes it a part of the policy, do the representations therein contained have the force of warranties?
   (b) If it is impossible to reconcile the written with the printed parts of an insurance policy, which shall govern?
   (c) Will overvaluation of the property by the insured void the policy? Explain.
2. (a) Is a condition that suit must be brought, if brought at all, within a specified time after loss a valid one?
   (b) Is an insurance policy a negotiable instrument?
   (c) If, after the contract of insurance is made but before the policy is delivered, a loss occurs and the insurance company refuses to deliver the policy or recognize liability, what courses, if any, are open to the insured?
3. The by-laws of a building association provided that all property upon which mortgages were held should be kept insured and the policy deposited with the association, and in the event of a failure of a borrowing member to procure insurance or secure a renewal, this was to be done by the association at his expense. Upon obtaining a loan from the association, John Jones procured insurance and deposited the policy as required by the by-law. When the policy expired he received no notice of it, and the association failed to secure a renewal, and the property being thereafter partially destroyed by fire, Jones sued the association for the loss thus sustained. What should the judgment be, and why?
4. Watson had two pieces of property insured under separate policies against destruction or loss. On Monday Watson assigned to Stevens the piece of property number one, without knowledge of the insurer, as the policy covering same was not also assigned. On Wednesday the piece of property number two was destroyed by fire, and the next day, before loss adjustment, Watson assigned to Fraser his insurance policy on the destroyed piece of property, without knowledge of the insurer. On Friday the piece of property number one was destroyed by fire. There was no element of fraud in anything that happened. (a) Can there be recovery under the policy on property number one? Explain. (b) Can there be recovery under the policy on property number two? Explain.

Negotiable Instruments

(Answer Three)

1. (a) State the elements necessary to impress the character of negotiability of an instrument.
   (b) In what two important respects does a negotiable instrument differ from one not negotiable?
   (c) Under the Negotiable Instrument Act what constitutes a payment of a sum certain, or under what circumstances may a sum payable be said to be a sum certain?
2. (a) What is the liability of a general indorser of a negotiable instrument?
   (b) What is meant by "protesting" paper? How is it done and what is the purpose of it?
3. A holder of a note demanded payment of the maker on date of the maturity, but had not the note with him, so payment was not made. Notice of dishonor was given to an indorser. Did this fix the indorser's liability? Why?

4. A, having to his credit $700 in the bank, gives check for the same to B. A, however, owes the bank $700 on a promissory note which is due, payable at the bank. B, without delay, presents the check at the bank for payment but payment is refused, although at time of the presentation A had the credit balance of $700. Shortly after presentation of the check, the bank charges the note up to A's account and balances it, stamps the note paid and mails it to A. Did the giving of the check by A to B, or the presentation of it at the bank, make a transfer of the money or a prior right to it; and can the bank be sued by B or A? Give reasons for your answer.

Partnership

(Answer Three)

1. (a) What events per se amount to a dissolution of a partnership?
   (b) What events or acts are grounds for dissolution of a partnership, and how may dissolution as a consequence of each be accomplished?
2. (a) Can a partner bind his firm by false representations?
   (b) What is the fundamental difference between a joint stock company and a partnership?
   (c) On what principle and for what reason is one partner liable for all the debts of the firm? Explain fully.
3. Jay, carrying on a mercantile business, desiring to increase his capital, borrowed $15,000 from Kay under a written agreement to pay Kay annually one-tenth of the net profits of the business in lieu of interest and to repay the principal sum when he should continue business. (a) What was the legal relation of Jay and Kay as between themselves? (b) And as to third persons?
4. Cummings, to secure an indebtedness of the firm of which he was a senior partner, executed in the name of the firm a mortgage on the real estate of the firm and another on its personal property. Both mortgages were given by Cummings without express authority from his co-partners and there was no subsequent ratification. Were these mortgages, or either of them, binding on the firm?

Sales

(Answer Three)

1. Succinctly, distinguish the following: (a) chattels real and chattels personal; (b) corporeal personal property and incorporeal personal property; (c) legal ownership and equitable ownership.
2. State the exact meaning of the term "conditional sales" as defined in the Uniform Conditional Sales Act.
3. White bought goods from Black at a time when White was insolvent and had no expectation of being able to pay for them. He made no false representations. He immediately sold the goods to Green in payment of a pre-existing debt. Green had no knowledge of the foregoing facts. As attorney for Black what action would you advise, and why?
4. Adams was a traveling man for Blum. He sold goods by sample. He sold Clark a bill of goods which Blum delivered. On his next trip Adams presented Clark with a statement for the goods, and was paid. Adams left the employment of Blum without accounting to him for the payment made by Clark. Blum sued Clark. What was the result, and why?

Taxation
(Answer Three)

1. (a) When personal property is located in one State and its owner is resident in another, which State taxes the property? Does the same or a different rule apply in case the property is real estate?
   (b) When does a tax become a lien on property?
2. (a) When does inheritance, succession or estate tax accrue? Against whom is such a tax chargeable under the Federal estate tax law? If this be different under the State statutes, explain.
   (b) Are a buyer's rights in land, under a tax title, equitable or statutory?
3. (a) As to method used in the valuation of inventories in determining income under the Federal Revenue Acts, what are the two fundamental requirements?
   (b) Under the income tax provisions of the Federal Revenue Acts, when the method of valuation used is cost or market whichever is lower, on what part of the inventory is there an important exception?
4. A taxpayer in 1931 purchased 500 shares of stock at $125 a share, and in 1934, by reason of the ownership of such stock, received 500 rights entitling him to subscribe to 100 additional shares at $100 a share. Upon issuance of the rights each of the shares of stock in respect of which the rights were issued had a fair market value of $120, and the rights had a fair market value of $3.00 each. The taxpayer exercised his rights to subscribe to the additional shares. Later, he sold one of such shares for $140.00. Compute his taxable gain on the sale, or state the rule applicable to the case.

Miscellaneous
(Answer Six)

1. How may a default of an employee terminate the liability of his surety?
2. What is the distinction between executor and administrator, if any, and whence do they derive authority?
3. What is the rule when one acting in a fiduciary capacity obtains a secret profit for himself out of his relationship?
4. In what one important particular does a bailment differ from a trust?
5. What determines the degree of diligence required of carriers, warehousemen, custodians and other bailees?
6. What do you understand by the terms: lands, tenements, hereditaments?
7. Generally, in case a mortgagor sells the mortgaged premises, what principles apply with respect to rights and obligations?
8. To what extent does the State legislature control the public streets or thoroughfares of a municipality?

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER, 1936

THURSDAY, NOVEMBER 19, 1936—1:00 P. M. TO 5:30 P. M.

Practical Accounting

PROBLEM 1:

From the following balance sheet prepared from the books and sent you by the auditor of the City of Sharon, prepare a reconstructed and adjusted statement, following nomenclature, classification and other practices which you believe express the best principles of municipal accounting; and append to your statement a reconciliation of book (a) surplus at June 30, 1935, and (b) excess of revenues over expenditures for the year ended June 30, 1936, with the corresponding items as you have determined them.

City of Sharon
Balance Sheet at the Close of Business, June 30, 1936

Resources

Water plant, constructed as at June 30, 1916, with bond issue of \$1,200,000 and current appropriations of \$50,000; estimated life, then and now, 100 years—		
Original cost		\$1,250,000.00
Additions as at June 30, 1924		266,800.00
Additions as at June 30, 1936		1,865.00
		\$1,518,665.00
Less—4½% serial bonds (\$20,000 payable semi-annually) in hands of public		400,000.00
City's equity in water plant		\$1,118,665.00
Taxes receivable from past years, of which 25% is believed to be uncollectible, less tax-anticipation notes of \$40,000.00, and estimated accrued interest of \$12,843.02 to be paid thereon		13,414.16
Taxes available for current year, of which it is hoped 90% will be collected—		
	Total Extended	
1st installment, past due	\$103,586.20	22,832.55
2nd installment, due September 1	103,586.20	87,273.64
Special assessments—		
Past due, including interest of \$6,347.50		34,803.91
Not due		23,327.63

Cash on deposit, including bond principal and interest of $29,000.00 due July 1, 1936			86,451.93
Tax liens (1934 and prior) worth about 70% of			15,279.25
Supplies on hand (cost)			3,480.42
Total resources			$1,405,528.49
Liabilities			
Vouchers approved for payment by council on June 25, 1936			$ 37,425.27
Contracts due and payable out of this year's appropriations			33,376.22
Other bills due			5,644.14
Total amounts owing to outsiders at June 30, 1936			$ 76,445.63
Lapsed appropriations, net			1,782.05
Appropriations holding over to next year (ending June 30, 1937), including bond principal and interest due July 1, 1936			43,119.63
Budgeted excess of income over expense			2,142.36
Taxes belonging to next year, collected in advance			1,000.00
General reserve (for working capital), created in 1925			50,000.00
Income from special assessment net interest			50.02
Special assessment bonds unpaid, $5,000 past due		$55,000.00	
Interest accrued thereon		2,318.73	
		$57,318.73	
Less—Cash collected and held in bank for bondholders		4,372.40	52,946.33
Surplus of resources—balance July 1, 1935			1,178,042.47
Total liabilities			$1,405,528.49

PROBLEM 2:

A statutory merger has been effected between Companies A, B, and C, and you have been asked to draft the journal entries for A as at October 31, 1936, in order to reflect the changes in the accounts made necessary by its acquisition of the net assets of Companies B and C and to prepare a balance sheet of Company A after giving effect to these entries. Changes in surplus, on the consolidated basis, should appear on the balance sheet.

At the date mentioned, the financial position of the companies was as follows:

Assets	*A*	*B*	*C*
Investment in A	......	$ 15,275.00	......
Investment in A's bonds	......	......	$ 10,740.00
Investment in B	$ 189,463.26	......	......
Investment in C	254,011.50	......	......
Intercompany accounts	84,795.33	......	60.72
Unamortized bond discount	6,300.00	......	......
Other assets	686,577.39	336,371.57	374,198.40
Total assets	$1,221,147.48	$351,646.57	$384,999.12

Liabilities			
Trade creditors	$ 241,546.93	$ 81,387.48	$ 63,273.43
Accrued interest on bonds	2,500.00	......	......
5% bonds outstanding	150,000.00	......	......
Intercompany accounts	346.52	25,366.81	59,142.72
Capital stock, par value $100	750,000.00	200,000.00	350,000.00
Earned surplus, or deficit*—			
Balance January 1, 1936	75,240.52	34,586.35	84,095.25*
Net profit, ten months	31,513.51	10,305.93	3,321.78*
Cash dividend, July 1	30,000.00*	......	......
Total liabilities	$1,221,147.48	$351,646.57	$384,999.12

The following particulars are given you:

(a) A's investment in B was acquired by cash payments to B's stockholders as at January 1, 1924, and consists of 90% of the capital stock of B Company; the surplus of B was then $30,357.18. Earnings since have been $62,535.10; and dividends paid, $48,000.00.

(b) A's investment in C is a 100% interest purchased as at January 1, 1934. The deficit of C on that date was $87,300.34; a net profit of $4,469.52 was earned in 1934 and a net loss of $1,264.43 was sustained in 1935.

(c) B's investment in A was purchased on the market in 1921 (the market on January 1, 1924, was $180 per share); it consists of 200 shares of A's 7,500 outstanding shares of capital stock, including a stock dividend of 100% paid by A on December 31, 1925, and is valued at original cash outlay. These shares will be canceled and retired as at October 31.

(d) C's investment in A's bonds, 1939 series, consists of 10 $1,000 coupon bonds, purchased at market on January 1, 1936. Coincident with the merger, the bonds have been canceled and cannot be reissued. A's bonds mature as follows:

Date of Maturity	*Amount*
June 30, 1937	$50,000.00
June 30, 1939	50,000.00
June 30, 1941	50,000.00

The bond discount has been prorated on the basis of prospective interest payable, but no amortization has been made as yet for the year 1936. No interest receivable has been accrued by C since the June 30 semi-annual coupon.

(e) The 200 minority shares of Company B are to be purchased for cash at book value as determined by you, B's investment in A remaining unchanged for the purpose of the purchase.

Consistently since the acquisition of its subsidiaries, Company A has presented consolidated financial statements to its stockholders.

PROBLEM 3:

You are requested to prepare a suitable statement of assets and liabilities of the XYZ Bondholders' Committee for the XYZ Transit Company. Your statement is to cover all transactions of the Committee during the period from January 1, 1927, the date of its inception, to June 30, 1936.

The records of the Committee are kept on a cash-receipts-and-disbursements basis. From them you derived the following information:

CASH RECEIPTS:

Proceeds of notes payable to the depositary, the A Trust Company	$440,000
Contributed by the XYZ Transit Company to the Committee's expenses	38,500
	$478,500

Cash Disbursed:	
Depositary fees	$106,000
Fees to attorneys of the Committee	45,000
Fees to Committee members	7,850
Salary of secretary of the Committee	15,000
Interest on notes payable	132,500
Listing of certificates of deposit on the Stock Exchange	58,000
Advertising, interest, principal payments, etc.	37,825
Printing and stationery	29,850
Mailing and postage	15,675
Sundry Committee expenses	8,675
Clerk hire	5,925
	$462,300
Deposited with the A Trust Company	$ 16,200

Other information discovered by you in the course of your examination included the following:

(1) Certain liabilities of the Committee were unpaid at June 30, 1936; these were—

Interest on notes payable for year ended June 30	$26,400.00
Depositary fees and expenses for the period January 1, 1936 through June 30, 1936	8,379.26
Fees to Committee members and attorneys	Undetermined

(2) The notes payable to the A Trust Company bear interest at the rate of 6%, are due on demand and are secured by $58,000,000 6% bonds of the XYZ Transit Company held by the A Trust Company as depositary.

(3) Of $60,000,000 6% bonds of the XYZ Transit Company outstanding, a total of $58,000,000 has been deposited with the Committee.

(4) The XYZ Transit Company has made payments on principal totaling 35% since January 1, 1927. Interest has been paid to date. Principal and interest payments have passed directly from the Transit Company to the bank, as trustee, and thence to the original bondholders.

(5) The depositary agreement provides that expenditures of the Committee are to constitute a first lien against deposited securities to the extent of 1% thereof.

(6) The agreement also provides that title to the bonds deposited with the Committee passes to the Committee. Certificates of deposit equal face value to the bonds have been issued to the depositors.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER, 1936

FRIDAY, NOVEMBER 20, 1936—8:30 A. M. TO 12:00 M.

Auditing

(Answer Ten Questions)

QUESTION 1:

In the accounts of the B Company you discover an item of unclaimed dividends which has been carried in the accounts-payable ledger in a constantly increasing amount over a period of years. On the balance sheet, the account has always been merged with trade accounts payable. How would you verify the account and what adjustment or other disposition of the item would you make in your annual audit of and report on the company's accounts?

QUESTION 2:

Would it be proper to include your audit fee among the liabilities of a company you are examining, where the work of the audit follows by two months the end of the fiscal period?

QUESTION 3:

What recommendations would you offer a client who desires to have his records reflect the best accounting practices with respect to trade and cash discounts on purchases? His capital is sufficiently large to insure his taking advantage of all discounts.

QUESTION 4:

How may an auditor test for raw-material overstock in a manufacturing business where perpetual-inventory records are maintained?

QUESTION 5:

What valuation of repossessed merchandise would you approve?

QUESTION 6:

The Federal income-tax law prescribes that the basis of valuation "in the case of merchandise on hand at the beginning of the year [shall be] the inventory price of such goods." Explain this statement and argue for or against it.

QUESTION 7:

What are some of the principal classes of contingent assets? Should they be mentioned in the balance sheet?

QUESTION 8:

A substantial amount of discount on capital stock has been charged to the fixed-asset account of a public-utility enterprise you are auditing. Would you approve of the procedure the company has followed? Indicate how you would disclose the item or dispose of it in your audit report.

QUESTION 9:

A wholly owned subsidiary of the B Company, whose books have been maintained on a cash basis, was liquidated during the year 1936 and in the course of the preliminary work accompanying your audit of the parent for the calendar year 1936 you find that the net amount of the liquidating dividend received consisted of the following items of the subsidiary's net worth:

Capital stock—common	$100,000.00
Earned surplus January 1, 1936	20,214.80
Net profit January 1, 1936 to June 30, 1936	65,487.44
Total dividend received, representing net assets having a fair market value of	$185,702.24

Without computing the tax, describe the various kinds of Federal taxes for 1936 to which the above items would be subject. If they are exempt from tax, why?

QUESTION 10:

In computing under the 1936 Federal Revenue Act the income tax, excess-profits tax and undistributed-profits tax, which of these taxes may be deducted from the income subject to these taxes?

QUESTION 11:

An investment company owns bonds of industrial corporations which it has purchased at different times at market. They are carried at cost and adjusted monthly on a pro rata basis so that at maturity their book value will be the redemption price. What is this method of adjustment called and how would you designate the method of valuation on the balance-sheet?

QUESTION 12:

C Company from time to time sells its accounts receivable to a discount corporation, with recourse, 80% of the account being advanced in cash. What balance-sheet notations does this call for? How would you as an auditor determine the unpaid accounts at the balance-sheet date?

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER, 1936

FRIDAY, NOVEMBER 20, 1936—1:00 P. M. TO 5:00 P. M.

Accounting Theory

(Answer Ten Questions)

QUESTION 1:

A 51% ownership in the common stock of a subsidiary was acquired in small amounts by its parent from the subsidiary's stockholders over a period of several years; the last purchase of approximately 5% on April 30, 1936, was sufficient for the parent to obtain its 51% control. In preparing a consolidated balance sheet reflecting the present ownership, how would you dispose of surplus of the subsidiary applicable to the various purchases in prior years, and how would you dispose of dividends now paid to the parent from such surplus?

QUESTION 2:

A smelting company credits gross income with the current market values of metals recovered from the refining of ores. This credit is made upon the date recovery is completed. When sales of the refined ores are made the variation between the sales price and market at the date production was completed is credited or charged to an account known as "Reserve for Inventory Variation." At the company's balance-sheet date the reserve had a credit balance exceeding $4,000,000. One company official takes the position that the reserve is a valuation account and should be deducted on the balance sheet from the inventory. Another regards the reserve as a part of earned surplus. Another states that it is in the nature of a general reserve available for absorbing inventory and other losses in the future. What is the reserve in your opinion, and how would you classify it on the balance sheet?

QUESTION 3:

Do you regard stock dividends as income to the recipient? How should they be recorded in the recipient's accounts, if at all? Disregard Federal income-tax interpretations unless you consider them appropriate.

QUESTION 4:

What do you understand by "market" in the expression "at the lower of cost or market"?

QUESTION 5:

Outline briefly the essential elements of the retail method of inventory control.

QUESTION 6:

How would you determine the book value of a given class of capital stock?

QUESTION 7:

On the balance sheet of an industrial company dated December 31, 1935, appears the title of an item in the net-worth section, "Acquired Surplus." What is your understanding of this term?

QUESTION 8:

Distinguish between a split-up and a stock dividend.

QUESTION 9:

What is a budget document?

QUESTION 10:

What, briefly, is the accountant's problem in the valuation of physical assets?

QUESTION 11:

Explain the following quotation and indicate your reasons for agreeing or disagreeing with it:

"The excess of the gross amount of an obligation over the net proceeds received therefrom represents interest payable at maturity, and on a balance sheet the unaccrued portion of such interest should appear as a reduction of the face value of the indebtedness."

QUESTION 12:

For purposes of a corporate report, what is the best method of disposing of losses incurred or discovered during the current year which have no relation to current operations?